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No. 1135

IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1946

UNITED STATES OF AMERICA, *Petitioner,*

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL., *Respondents.*

BRIEF OF RESPONDENT, PUBLIC UTILITIES COMMISSION, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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DIVISION OF PRINTING AND PUBLICATIONS—GOVERNMENT OF THE DISTRICT OF COLUMBIA

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COUNTER STATEMENT

The Public Utilities Commission of the District of Columbia (Commission) instituted an investigation to determine whether the sliding-scale arrangement should be abandoned or modified, and if to be modified in what particulars. This investigation was consolidated with the annual rate investigation under the plan for the year 1943.

The Public Buildings Administration of the Federal Works Agency and the Procurement Division of the Treasury Department intervened in the proceedings before the Commission, both in the name of the United States. Both agencies took contrary positions on all issues involved. The Public Buildings Administration contended that pursuant to a design and conspiracy, the sliding-scale arrangement was adopted as a device by which excessive, unlawful and unreasonable rates were to be extracted from consumers (R. 505, 507), and urged that the arrangement be abandoned. The Procurement Division urged that the principles of the sliding-scale plan be preserved but that it be modified in certain particulars (R. 10).

The only witness called by the Public Buildings Administration was Charles W. Smith, Chief of the Bureau of Accounts, Finances and Rates of the Federal Power Commission, who testified that he envied the sliding-scale arrangement because it has benefits to the public as compared to the typical fair-value procedure (R. 396). He pointed out the benefits of the plan (R. 378, 379, 398). Professor James C. Bonbright of New York City, Economist, Professor of Finance of the Business School in Columbia University and specialist in public utility matters, was called as a witness by the Procurement Division and recommended certain modifications of the sliding-scale arrangement. He testified "that the sliding-scale plan deserves substantial credit, both for the promptness and for the amount of the reductions in residential rates" (R. 408).

The sliding-scale plan was adopted in a Consent Decree of the Supreme Court of the District of Columbia (now the District Court) on December 31, 1924 (R. 57-62), after seven years of litigation (R. 3). The Court found the plan was "fair and reasonable" (R. 60). Paragraph 18 of the Act (37 Stat. 980) provides that no sliding-scale arrangement shall be lawful until it shall be found by the Commission "after investi-

gation, to be reasonable and just and not inconsistent with the purposes" of the Act.

In the court below the Petitioner argued that the sliding-scale plan was illegal from its inception and has resulted in the extraction from the consumers of illegal and unlawful rates. It said the arrangement was "unlawful in its inception, and has always been unlawful in its administration" (R. 660, Note 27). The lower court said "The foundation upon which all the argument of the United States rests is its contention that, throughout the many years during which the sliding scale arrangement has been in effect, the rates have been excessive and illegal" (R. 662).

Under the arrangement, rates have been reduced each year since the plan was adopted except for the year 1942 when no rate adjustment was required (R. 6). While the company has earned, from 1925 to 1942, $16,130,385.49 above the basic rate of return used as a measure for rate adjustments, the consumers have, during the same period, had cumulative savings of more than $86,000,000 without giving consideration to the additional savings applicable to increased consumption in each of the years (R. 8).

Two different People's Counsel, appointed by the President and confirmed by the Senate, speaking for the consumers, have opposed the contentions made by the Petitioner in the instant proceeding.[1]

The Petitioner contended in the courts below and contends here, that the sliding-scale arrangement was illegal in its inception and was illegally applied, and that rates in effect since 1925 have been illegal and unlawful. Based upon this erroneous conclusion the Petitioner says the surplus and part of the depreciation reserve of the Potomac Electric Power Company (Company or Pepco) are illegal and that the Com-

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[1] When there was no People's Counsel to speak for the consumers, the Federation of Citizens Association intervened in the District Court and filed a brief as *amicus curiae* in this Court in opposition to the same general contentions raised by the same Petitioner in another proceeding. *Vinson* v. *Washington Gas Light Co.*, 321 U. S. 489.

mission should "recapture" (Pages 6, 18, Note 15) for the consumers, all of the company's assets which have been acquired from undistributed earnings. The Petitioner contended below that $29,000,000 should be excluded from the rate base for this reason (R. 659). It seeks to recapture from the company approximately 36% of the actual cost of the property devoted to public service. It seeks a rate base representing approximately 64% of the actual original cost of the property used in the public service. Neither the statute nor the sliding-scale plan authorizes the Commission to "recapture" any part of a utility's property. Paragraph 7 of the Act (37 Stat. 978) requires the Commission to value the property of every public utility "actually used and useful for the convenience of the public at the fair value thereof at the time of said valuation".

Both the Public Buildings Administration and the Procurement Division filed applications for reconsideration of the Commission's Order No. 2796. The Procurement Division contended before the Commission that the company's rate base as of December 31, 1943, "did not exceed $67,000,000" (R. 15 and 228). The Public Buildings Administration called as its only witness Charles W. Smith, Chief of the Bureau of Accounts, Finance and Rates of the Federal Power Commission, who testified that the prudent investment rate base was $82,749,207 (R. 423, 604). In disregard of this evidence of its witness, the Public Buildings Administration contended the rate base should not exceed $53,459,000 (R. 16).

In its application for reconsideration, the Procurement Division contended that the rate reduction should be "not less than $3,000,000" (R. 227). The Public Buildings Administration contended that the rate reduction should be "at least $3,860,000 (R. 235). But its witness testified that the excess over the return was $2,030,530 (R. 605), which on the sliding-scale principle would allow a rate reduction of only $1,015,265. The Commission fixed the rate reduction in the amount of $1,037,189 (R. 43, 45).

Witness Charles W. Smith for the Public Buildings Administration, testified that the reserve for depreciation to be deducted from original cost of property was $17,782,057 (R. 423, 604). In disregard of this testimony, the Public Buildings Administration contended the accrued depreciation to be deducted from the original cost of property was $17,071,000 (R. 16). Mr. Smith testified that the book reserve for depreciation was the proper amount to be used in establishing a rate base (R. 368, 369, 395, 397). In its application for reconsideration, the Public Buildings Administration contended that the Commission "erred in accepting a book depreciation reserve" (R. 234).

The Procurement Division contended in its application for reconsideration, that the Commission erred in failing to find the depreciation reserve to be $21,600,000 (R. 228). In the complaint in the District Court, the Petitioner alleged that $14,000,000 should "be added to the depreciation reserve and so included in the amount to be deducted from the gross rate base" (R. 52).

When the Petitioner filed its complaint below on behalf of the two Federal agencies, it did not allege what amount the rate base should be nor what the depreciation reserve to be deducted from original cost should be, nor by what amount the rates should be reduced (R. 47-56).

Both here and below, the Petitioner contended that the entire surplus be excluded from the rate base (R. 15, 16, 659, 661). The only witness presented by the Petitioner on the subject of the value of the property, testified that the rate base should consist of the original cost of the property used less the book reserve for depreciation (R. 422, 423, 604). The witness included in his Exhibit No. 45, reproduced on Record page 604, all of the property acquired from undistributed earnings. The Petitioner also contended that the entire surplus should be excluded from the statement of the invested capital (R. 16, 55, 232). Arthur E. Lundvall, Chief Accountant for the Federal Trade Commission, was presented as a witness

for the Procurement Division (R. 334), and testified that the original investment and undistributed earnings invested in assets constituted the invested capital and was part of the common stock equity (R. 390-392). Professor Bonbright, another witness for the Procurement Division, testified that earnings should be calculated on the common stock equity (R. 412).

The original sliding-scale arrangement provided for a rate base as of January 1, 1925, of $32,500,000 and a depreciation reserve as of December 31, 1924, of approximately $4,000,000. It provided that the rates for the year 1925 were to be based upon a return of 7½% on the value so stated plus estimated cost of additions undepreciated and weighted. The plan provided that on the depreciation reserve "interest will be accrued on a 4 percent basis and as an accretion to the reserve, lessening the amount of depreciation to be included as an expense of operation" (R. 58). Under the sliding-scale plan, all additions to property have been included in the rate base, weighted, at the actual cost of the property, so that as existing property was retired the rate base would become the actual cost of the property. The rate base established under the plan before it was modified by Order No. 2796 was approximately 95 percent original cost (R. 19). Thus, the rate of return of 6 percent prior to the reduction in the rate of return in Order No. 2796 was applied to a weighted rate base approximating 95 percent of the actual cost of the property used.

The original plan provided that "if the rates hereafter yield more than a 7½ percent return" on the rate base "during a period of any one year, one-half of said excess shall be used in a reduction of rates to be charged the public for electric service thereafter" thereby providing a sliding-scale of rates "advantageous to the public and company alike; that is to say, by way of example, if the return for any one year should amount to $100,000 over and above 7½ percent on the base ascertained as aforesaid then the rates for the succeeding year to be charged the public shall be automatically reduced by the

filing of new rate schedules to absorb $50,000 of such excess during such year" (R. 58-59).

The plan also provided for rate increases "If the average return for any consecutive 5-year period" falls below 7½ percent, or if the average return "for any consecutive 3-year period" falls below 7 per cent, or if the average return "for any consecutive 12-month period" falls below 6½ per cent on the rate base (R. 59).

The basic rate of return was reduced by the Commission in 1931, 1935, and 1937, and upon each modification the percentage steps for rate adjustments, up or down, were likewise modified to conform to the new basic rate of return (R. 4).

During the period 1925 to 1930 inclusive "when the basic rate of return allowed was 7½%, the average rate of return actually earned over this period was 10.03% per annum; during the years 1931 to 1934, inclusive, during which period the basic rate of return allowed was 7%, the actual average rate of return was 8.46%; during the 2 years 1935 and 1936, when the basic rate of return was 6½%, the actual return was 7.42% and 7.91% for each of these respective years (R. 7). From 1937 to 1942, inclusive, during which period the basic rate of return established was 6%, the actual return earned ranged from 7.95%, down to 5.99% or an average of 6.91%" (R. 7). During the period from 1937 through 1943 when the basic rate of return was 6% "the actual return, on the average, was but .91 of 1% in excess thereof" (R. 7).

In 1924, before the sliding-scale plan was adopted, the cost of 100 kwh consumption for residential service in the District of Columbia was $9.24, as compared with an average cost of $6.18 in 150 cities having a population of 50,000 or more (R. 5, Table between R. 566 and 567). For the year 1942, the cost for 100 kwh for residential service in the District of Columbia was $2.56, as compared with an average cost of $3.80 for all cities having a population of 50,000 or more (R. 6).

In the first year of the operation of the sliding-scale plan the cost of 100 kwh was reduced from $9.24 to $7.02. Since 1930 the cost of 100 kwh for residential service in the District of Columbia has steadily declined below the cost of cities having 50,000 or more population (Table between R. 566 and 567). The billing cost of 100 kwh for residential consumption in the District of Columbia has declined to 27.7 per cent of the 1924 cost while the average cost of seven comparable electric utilities has declined to 69.5 per cent of the 1924 cost (R. 566).

In 1924, before the sliding-scale was adopted, the monthly bills for 25 kwh for residential consumption in the District of Columbia was $2.50, while the average cost of 25 kwh for residential consumption of seven comparable electric utilities was $1.93. In 1942, the billing cost of 25 kwh for residential consumption in the District of Columbia had declined to $0.98, while the average for the same seven comparable electric utilities was $1.38. The cost of 25 kwh for residential consumption in the District of Columbia has steadily declined below the billing cost in the seven companies so that the cost in 1942 was 39.2% of the 1924 cost, while the average cost of the same seven companies was 71.5% of the 1924 cost (R. 564).

Before the sliding-scale was adopted the billing cost of 40 kwh for residential consumption in the District of Columbia was $4.00, while the average cost of seven comparable electric utilities was $2.87. From the first year of the operation of the sliding-scale plan, the cost for 40 kwh for residential consumption in the District of Columbia has steadily declined. In 1942 the cost of 40 kwh for residential consumption in the District of Columbia was $1.48, while the average cost for the same seven comparable companies was $2.04. The cost of 40 kwh in the District of Columbia has declined to 37% of the 1924 cost, while that for the seven comparable companies has declined to only 71.1% of the 1924 cost (R. 565).

The Petitioner argues that Pepco's depreciation reserve is excessive and constitutes, in part, unjust contributions by con-

sumers. In 1942 the depreciation deduction of Pepco was 10.3% of its revenue, while the average depreciation deduction of ten comparable electric utilities was 10.6% of their revenue (R. 557). Pepco's charge for depreciation in 1942 was 2.2% of its electric plant, while the average of the same ten comparable companies was 2.6% of their electric plant (R. 557). On December 31, 1942, the ratio of Pepco's depreciation reserve to the cost of its electric plant was 17.29% while the average ratio of ten comparable electric utilities was 17.84% (R. 560). The reserve for depreciation of the electric plant of Pepco December 31, 1942, was $16,667,162, while the average depreciation reserve for electric plant of the ten comparable companies was $17,511,135 (R. 560). Pepco's investment in electric plant on that date was $96,421,616, while the average investment in electric plant of the ten companies was $98,148,320 (R. 560).

The Petitioner argues that the Commission should deduct from Pepco's common stock equity $29,000,000 because, as it alleges, the surplus was built up by unlawful and illegal rates. The total common stock equity of Pepco, December 31, 1942, was $37,841,987 while the average common stock equity of ten comparable electric utilities was $40,381,008 (R. 560).

The capitalization ratios of Pepco, December 31, 1942, were 47.15% for long-term debt, 8.25% for preferred stock, and 44.60% for common stock equity, while the average of the ten comparable electric utilities were 47.39% for long-term debt, 13.54% for preferred stock, and 39.07% for common stock equity (R. 561).

The rate base established by the Commission in Order No. 2796 is the original cost of the property, less the depreciation reserve (R. 19, 21). The Commission found that the original cost of the electric plant on December 31, 1943, weighted, amounted to $98,633,399.89 (R. 19, 21). After deducting contributions in aid of construction and deposits for extension, and adding materials and supplies, the Commission found the gross rate base on December 31, 1943, weighted, to be $98,615,-

839.52 (R. 21, 42). From the weighted gross rate base, the Commission deducted the depreciation reserve adjusted and weighted for the year 1943 in the amount of $17,844,120.81 and found a weighted depreciated original cost rate base for the year 1943 of $80,771,719.04 (R. 42). It was upon this rate base that the Commission applied the new basic rate of return of 5½% to determine the amount of the rate reduction (R. 42-43). Giving effect to the rate reduction of $1,037,-189, and to the estimated savings in Federal income and excess profits taxes, the Commission found the company's pro forma net income for the year 1943 would amount to $3,645,093.89. After providing for preferred stock dividends it would leave $3,250,058.78 to provide a return of 8.91% on the company's common stock equity at December 31, 1943. The rate of return stated on page 10 of the Petition is the rate of return only for the year 1943.

The various statements in the Petition that the basic rate provided in the sliding-scale arrangement is the "established rate" are not correct. The sliding-scale plan permits the company to earn more or less than the *basic* rate which is used as a measure to determine rate adjustments (R. 40, 58, 59, 372). The rate of return referred to on page 9 of the Petition is "the allowed return" under the provisions of the sliding-scale arrangement and is the return only for the year 1943. The Commission's finding points out "that the return at the basic rate of 5½% of the rate base is not the actual return allowed the Company before any reduction is made in rates for the ensuing rate year, but is that amount plus a portion of the earnings in excess of such return. During the year under consideration, the allowed return is therefore 5.82%" (R. 40). This is what the lower court called the "permissible rate of return" (R. 659).

On page 5 of the Petition, it is said the sliding-scale arrangement originally provided that the rates were to yield 7½% return. The original sliding-scale plan (R. 58-59) did not provide that the rates were "to yield" a rate of return of

7½%. That rate was the *basic* rate of return to be used in adjustment of rates. The plan provided that additions to property should be included in the rate base at the actual cost (R. 58), so that as property was retired the rate base approached original cost of property. In 1943, the rate base under the sliding-scale plan before it was amended approximated 95% original cost of property (R. 18-19). The Commission reduced the basic rate of return to 5½% which was applied to the depreciated original cost of property, weighted for the year 1943 (R. 38, 42).

On page 7 of the Petition the Petitioner says that under its construction of the sliding-scale arrangement the Commission "in adjusting rates for each year, has sought to fix rates which would yield the established return plus one-half of the excess of the past year." This statement is misleading. The plan itself provided the formula for adjustment of rates. That formula has been strictly followed by the Commission in every rate adjustment (R. 41). The actual rate reductions made each year under the plan is set out on Record page 6. The net amount available for return in each of the years is shown on Record page 8, and shows the actual rate of return allowed by the plan as well as the basic rate of return used for the purpose of making rate adjustments. The basic rate of return applied to the net amount available for return shows that the actual rate reductions made are in exact accordance with the sliding-scale arrangement (R. 6, 8).

The application for reconsideration filed by the Public Buildings Administration contended that the Commission erred in failing to cause the cancellation of watered stock of Pepco (R. 233), and that the Commission erred in failing to exclude such watered stock from the invested capital in the cost-of-capital computation of the rate of return (R. 233). The Commission's findings show that no part of the so-called "watered stock" was included in the statement of the common stock equity (R. 16). At the time of the reclassification of the fixed capital accounts of Pepco, in accordance with orders

issued by the Federal Power Commission and by the Public Utilities Commission, "all differences between original cost and the book cost of property were eliminated from the plant account of Pepco, with corresponding charges against earned surplus and other appropriate accounts. Thus, no inflationary or improper amounts are reflected in the equity capital as presently constituted and used in this study of cost of invested capital" (R. 35, 36).

SUMMARY OF ARGUMENT

1. The Commission found as a matter of fact that the company's surplus or undistributed earnings was invested in assets used in public service. It found as a fact that this investment constitued part of the invested capital and that property representing such investment was a part of the rate base. The Courts have universally held that funds invested, from whatever source, are part of "invested capital" and that property acquired from undistributed earnings or depreciation reserve is as much a part of the rate base as property acquired from proceeds from the sale of securities.

The Petitioner's contention that surplus invested in used assets should be excluded from the rate base and from a statement of invested capital is contrary to the testimony of its own witnesses and all other evidence of record. The contention is based upon argument without support that rates in effect since January 1, 1925, have been illegal. The exclusion from the rate base of all property acquired from undistributed earnings would be a clear violation of the statute and of the Constitution.

2. The contention that the sliding-scale resulted from a conspiracy to establish a device to extract from consumers unlawful and unreasonable rates is disproved by the record of the rate reductions. The statement is contrary to testimony of witnesses called by the Petitioner. It is contrary to the belief expressed by consumers.

3. The decision below is not in conflict with the decisions of this Court nor with that of any Circuit Court of Appeals. It is in accord with principles announced by this and other courts. This Court has reviewed the statute involved and held contrary to one of the positions taken by the Petitioner. This Court has approved a sliding-scale arrangement adopted under the statute involved. No valid reason has been advanced in the Petition for granting a writ of certiorari.

ARGUMENT

I

Undistributed Earnings Invested in Used Assets Constitute Invested Capital, and Property So Acquired Is Part of the Rate Base.

On page 13 of the petition, the Petitioner says that the Commission acted, and the court below affirmed that action, on the erroneous assumption that "as a matter of law, exclusion of the surplus could not be sustained." On page 15 it said the Commission and the court below held that the Commision is "without power to exclude from the rate base and the common stock equity" the company's surplus. Neither the Commission nor the court decided that question on the narrow ground stated by the Petitioner. The Commission found upon undisputed evidence that the surplus referred to was invested in property used in the public service and that such property constituted property of the company as much as property acquired from any other source of funds. There is no testimony in the record that property acquired from undistributed earnings or surplus is not used in the public service. There is no testimony in the record that the surplus is illegal and unlawful. The Petitioner's contention is based upon argument that is contrary to the evidence. The lower court said:

> "The foundation upon which all the argument of the United States rests is its contention that, throughout the many years during which the sliding scale arrangement has been in effect, the rates have been excessive and illegal" (R. 662).

The Commission said the elimination of earned surplus or undistributed earnings from invested capital "finds no support in reason or in law" (R. 15). It said that it is universally recognized by both courts and regulatory authorities that undistributed earnings invested in the assets of a corporation "are just as much a part of invested capital as are the dollars obtained by the sale of securities" (R. 16). The Commission rejected the contentions "on the grounds that their adoption would be unsound, without merit, inequitable, and at complete variance with established law" (R. 17).

Mr. Lundvall, who is Chief Accountant of the Federal Trade Commission (R. 334) testified as a witness for the Procurement Division that the investment in the business is not merely the amount invested in capital stock but that amount and what has been "left in the business of the company" (R. 390). He said the amount paid for capital stock is not the only investment, but it is that amount "plus whatever was left in the business from year to year" (R. 391). This witness for the Petitioner did not agree with the contentions of his counsel.

Mr. Charles W. Smith, Chief of the Bureau of Accounts, Finances and Rates of the Federal Power Commission, testified as a witness for the Public Buildings Administration and introduced Exhibit No. 45 which is reproduced at Record page 604. He testified that his exhibit showed "the cost of utility plant at the end of 1942", and that this figure "reflects the book cost of the plant" with "the average net additions for 1943" (R. 422). The witness testified that the gross investment "is the investment in the plant used and useful, averaged for the year 1943" (R. 423). After deducting con-

tributions in aid of construction "representing amounts which have not been furnished by stockholders and are other than investments by the company itself", with working capital, gives "a prudent investment rate base for 1943 of $82,740,000" (R. 423). Mr. Smith testified that "the prudent investment method is by far the best method of determining the rate base in my opinion" (R. 419). Mr. Smith included in his prudent investment rate base all of the property acquired from surplus or undistributed earnings (R. 604).

The Petitioner's statement on pages 13 and 15 of its petition that the Commission and the Court of Appeals refused to exclude from the rate base property acquired from earned surplus or undistributed earnings because of lack of power or because such action could not be sustained as a matter of law, is only one reason why the contention was rejected. It is not the principle reason for which the Commission and the court below rejected the unsupported argument. The Commission found as a matter of fact that the surplus was invested in assets used in the public service.

That the earned surplus is invested in used and useful property is not denied. The Petitioner has not contradicted this fact. It merely seeks by argument to show that because the company has had a record of good earnings, *ipso facto*, the rates have been illegal and unlawful.

The property acquired from earned surplus is included in the "Original cost of electric plant 12/31/43" shown in the table on Record page 21. In its finding of the rate base, the Commission said it "finds that the electric plant component of the gross rate base shall be the original cost of property used and useful in public service as at December 31, 1943, or $102,-434,682.29 (unweighted), and $98,633,399.89 (weighted)" (R. 19). These are the figures shown in the table on Record page 21.

The Commission having found as a fact that the earned surplus was invested in property used in service, held that both upon the facts and the law, property so acquired should

not and cannot be excluded from the value of the property. The Court of Appeals sustained the Commission's action by saying there is a clear line of authority holding that surplus invested in business is part of the "invested capital" and that it had been unable to find any contrary authority (R. 661).

Both the District Court and the Court of Appeals rejected the unsupported argument of the United States.

This court has never held directly or indirectly that property acquired from undistributed earnings should be excluded in the determination of a rate base. To the contrary, every time this Court has spoken on the subject it has held that property paid for out of revenue for services belongs to the company, just as does that purchased out of proceeds of bonds and stock. Some of such decisions are: *Board of Commissioners* v. *New York Telephone Co.*, 271 U. S. 23; *Los Angeles Gas & Electric Corporation* v. *Railroad Commission*, 289 U. S. 287; *Clark's Ferry Bridge Co.* v. *Public Service Commission*, 291 U. S. 227; *Newton* v. *Consolidated Gas Co.*, 258 U. S. 165; *Galveston Electric Co.* v. *Galveston*, 258 U. S. 388; *Smith* v. *Illinois Bell Telephone Co.*, 282 U. S. 133; *Lynch* v. *Hornsby*, 247 U. S. 339; *Peabody* v. *Eisner*, 247 U. S. 347.

There is not a decision of a Circuit Court of Appeals that sustains the argument of the Petitioner that earned surplus invested in property is not a part of the invested capital. In *City of Minneapolis* v. *Rand*, 285 Fed. 818, and in *Garden City* v. *Garden City Telephone, Light & Manufacturing Co.*, 236 Fed. 693, the Eighth Circuit Court of Appeals said that it cannot be said that the utility is not entitled to the profits it has made and that it could not stop to inquire how the utility acquired title to the money invested.

In *Flynn* v. *Haas Bros.*, 20 F. (2d) 510, 511, the Eighth Circuit Court of Appeals said invested capital means "* * * and (3) paid in or earned surplus and undivided profits used or employed in the business; * * *."

In *Eaton* v. *English & Mersick Co.*, 7 F. (2d) 54, the Second Circuit Court of Appeals said that surplus used in the business is "invested capital".

The ground upon which the United States asks this Court to grant a writ of certiorari is directly contrary to the position taken by the Assistant Attorney General before the Court of Appeals for the District of Columbia and that court's decision in *Geo. Feick & Son Co.* v. *Blair*, 58 App. D. C. 168, 26 F. (2d) 540, 541, where it was conceded that the amount of accumulated dividends should not be excluded from invested capital (Page 541). The court held in that case that the surplus remained as property of the corporation to be used in its business "and as such is part of its invested capital" (Page 542).

The State Courts have held contrary to the argument made by the Petitioner. *Peoples Natural Gas Co.* v. *Pennsylvania Public Utilities Commission*, 34 A. (2d) 375, 153 Pa. Super, 475; *State* v. *Hampton Water Works Co.*, 18 A. (2d) 765, 91 N. H. 278; *City of Cincinnati* v. *Public Utilities Commission*, 148 N. E. 817, 113 Ohio St. 259; *Michigan Public Utilities Commission* v. *Michigan State Telephone Co.*, 200 N. W. 749, 228 Mich. 658.

In *Fall River Gas Works Co.* v. *Board of Gas & Electric Light Commissioners*, 102 N. E. 475, 480, 214 Mass. 529, the court said when a utility has surplus earnings they belong to the corporation and not to the public.

In *Grafton Electric Light & Power Co.* v. *State*, 94 A. 193, 195, 77 N. H. 539, counsel for the Public Utilities Commission of the State of New Hampshire made the same argument that the Petitioner made in the court below and is making here, because, as he contended, the public had some vague interest in the utility's surplus which had been accumulated. The court said:

> "Since it is their property, it cannot be taken from them directly, nor can they be deprived of it indirectly, either in whole or in part, by denying to its owners the right to use it as they could use their own property."

In *Gibbons* v. *Mahon*, 136 U. S. 549, 34 L. ed. 525, this Court said that reserved and accumulated earnings held and invested by the corporation were a part of the corporate property, and that whether profits should be invested or distributed is a matter to be determined by the corporation. In *Eisner* v. *Macomber*, 252 U. S. 189 (which the United States in *Helvering* v. *Griffiths*, 318 U. S. 371, asked this Court to reconsider and over-rule, which request was denied) this Court said every dollar of original investment, together with whatever accretions and accumulations have resulted from employment of money, still remains property of the corporation.

In footnote 13 on page 16 of the petition, it is said that the Securities and Exchange Commission assumed in *Re: Potomac Electric Power Co.*, 8 S. E. C. 30, 36, that it was discussing surplus accumulated from fair and reasonable rates. The Securities and Exchange Commission was discussing the same surplus that the United States discussed in its petition. In that proceeding before the Securities and Exchange Commission, the United States made substantially the same argument that it made in the court below and is making here. The Securities and Exchange Commission did not agree with the contention.

The exclusion from the rate base of property acquired from undistributed earnings would be a clear violation of Paragraph 7 of the Act (37 Stat. 978) that the Commission shall value the property "actually used and useful for the convenience of the public at the fair value thereof at the time of said valuation". Such exclusion would be a clear violation of the Federal Constitution.

The Petitioner has modified its argument by now contending that the Commission should have excluded all of the surplus "or a portion thereof" (Pages 3 and 10). The Petitioner apparently now takes the position that if it cannot have all, there is no harm in asking for less.

The difficulty with the position of trying "to settle for less" is, that there is no basis in the record for half measures. When the Petitioner was before the Commission through two agencies, and before the lower courts, it contended that all of the surplus was "illegal" (R. 16, 55, 659, 661). But it offered no evidence that any part of the surplus was illegal. Before the Commission it contended there should be excluded from the rate base "an amount of property equal to Pepco's earned surplus" (R. 15, 16, 232). It made the same argument before the Court of Appeals (R. 659, 661). This fact was noted by the Court of Appeals in footnote 33, Record page 662. Perhaps this is the reason the Petitioner now is willing to settle for less.

The reasons advanced in the petition for the granting of a writ of certiorari are based solely upon argument that is contrary to the evidence in the record. It is contrary to the testimony of witnesses for the United States; it is contrary to witnesses of the Commission; and is contrary to the findings of fact of the Commission. It is contrary to the decisions of the District Court and of the United States Court of Appeals. The Petitioner's position is not even based upon opinion testimony. In *Dayton Power & Light Co.* v. *Public Utilities Commission*, 292 U. S. 290, this Court said that opinion testimony had evidentual value but nothing more. It has no such commanding quality as to apply coercion to the judgment of the appointed triers of the facts. If opinion evidence has no such commanding quality, is pure "argument", based upon erroneous conclusions, sufficient to coerce the judgment of a regulatory body?

In footnote 11 on page 14 of the petition, the Petitioner says the company's "actual investment" was $2,245,000 from 1925 to 1942, and $5,245,000, thereafter. Elsewhere in the petition, these amounts are referred to as the "actual investment". This statement is contrary to the evidence. It is contrary to the testimony of witness Charles W. Smith for the United States (R. 422, 423, 604); it is contrary to the testi-

mony of the Commission's Executive Accountant and Auditor (R. 290, 291, 589); it is contrary to the testimony of Mr. Arthur E. Lundvall, Chief Accountant for the Federal Trade Commission who appeared as a witness for the Procurement Division of the Treasury (R. 390, 391, 392); it is contrary to the Commission's finding of fact (R. 9, 19, 21, 35).

From this misstatement of the actual investment, the Petitioner draws erroneous conclusions about the earnings under the sliding-scale arrangement. These conclusions are contrary to Petitioner's witnesses Smith and Lundvall and its witness Professor Bonbright (R. 412). It constructs from these erroneous conclusions the tables in Appendix "A" of the petition.

The conclusions stated by the Petitioner on page 14 and subsequent pages and in Appendix "A" are contrary to the decision of the Court of Appeals when it was discussing the same contention below, and said:

> "However, this analysis provides but one of the types of information which the Commission must take into account in arriving at a 'reasonable' rate. These earnings, in percentages, are meaningful only when they are related to the Company's total capital structure" (R. 661).

The argument made by the Petitioner and the erroneous conclusions it draws concerning the relationship of earnings to par value of common stock are contrary to decisions of regulatory bodies generally, and contrary to authorities on the subject.[2]

Courts have universally held that proceeds from surplus or depreciation reserve or any other source invested in assets constitute part of invested capital. Cases cited, *supra*, and *Miles* v. *Safe Deposit Co.*, 259 U. S. 247; *Bailey* v. *N. Y. C. & H. R. R. Co.*, 89 U. S. 604, 22 L. ed. 840; *Martindell* v. *Fidu-*

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[2] "The Economics of Public Utility Regulation", Barnes, Page 265; "Financial and Operating Ratios in Management", Bliss, Pages 58, 75; "Public Utility Finance", Lagerquist, Page 567.

ciary Counsel, 30 A. (2d) 281, 133 N. J. Eq. 408; *People Ex rel Fraser* v. *Great W. Sugar Co.,* 29 F. (2d) 810.

On page 17 of its petition, the Petitioner says that Pepco's surplus "represents amounts accumulated as the result of illegal and improper depreciation practices and of exorbitant earnings". On the intervening pages and again on page 21, the Petitioner makes the same unwarranted statement.

On pages 19 and 20, the Petitioner quotes only a part of Paragraph 16 of the Act and from that argues that the sliding-scale plan and the Commission's application of it "violated the basic depreciation principles established in Pargraph 16".

In *Washington Gas Light Company* v. *Byrnes,* 78 U. S. App. D. C. 107, 137 F. (2d) 547, and in *Vinson* v. *Washington Gas Light Company,* 321 U. S. 489, the United States made precisely the same argument where the sliding-scale there involved provided, as does the one here involved, for accrual of 4% interest on the depreciation reserve as an accretion thereto, and thereby a lessening of the amount of depreciation to be included in the annual expenses of operation. As pointed out by both the Court of Appeals and this Court, the argument in that case was premised primarily upon *Federal Power Commission* v. *Natural Gas Pipeline Co.,* 315 U. S. 575. Both Courts rejected that argument. This Court said the argument was "unsupported by our cases".

The assumptions upon which the Petitioner bases its argument that the Commission has violated the provisions of Paragraph 16 are contrary to evidence of record. Charles W. Smith, who testified as a witness for the Commission on the subject of depreciation and depreciation charges, and later as a witness for the Public Buildings Administration upon a prudent rate base, testified that the practice of the Commission under the sliding-scale plan did not permit the company to accrue a sufficient depreciation reserve (R. 368, 397). He did not agree with the position taken by the Petitioner as to the applicability and meaning of Paragraph 16 (R. 368, 374, 377, 380, 397). As a witness for the Public Buildings Administra-

tion, Mr. Smith testified that the average reserve for depreciation in 1943, which he deducted from the gross base to determine the prudent investment rate base, was $17,782,057 (R. 604). While Mr. Smith testified that the sliding-scale plan had not provided a sufficient reserve requirement, he recommended that the book reserve be deducted in determining the rate base (R. 368, 369, 397).[3]

In spite of the assertion on pages 17 and 21 of the petition that the Company's surplus represents amounts accumulated as the result of illegal and improper depreciation practices, the Petitioner alleged in its complaint in the District Court that Paragraph 16 of the Act "requires that $14,000,000 be added to the depreciation reserve and so included in the amount to be deducted from the gross rate base in arriving at the base on which a return was to be allowed" (R. 52).

Before the plan was modified, depreciation reserve was treated by the Commission as a source of funds (R. 22, 589). The 4% interest credit to that reserve was considered by the Commission as a part of the cost of funds and was, therefore, given its proper weight in the determination of a proper rate of return. The Commission found that "By using an undepreciated rate base and deducting interest on the reserve balance from the depreciation accruals, and giving effect to the interest rate applied to the reserve in fixing the rate of return, the result obtained is the same as that arrived at by the use of a depreciated rate base" (R. 22). Since the result is the same under either method, it follows that Petitioner's contention is wholly without merit.

II

The Sliding-Scale Arrangement Is a Reasonable and Lawful Method of Rate Adjustment

The assertion by the Public Buildings Administration that the sliding-scale arrangement was adopted pursuant to a de-

[3] Professor Bonbright who was also a witness for the United States testified that the depreciation reserve accumulated under the sliding-scale plan was inadequate (Page 2200 of the Transcript).

sign and conspiracy to establish a device to extract unlawful and unreasonable rates and was so tolerated by the members of the Commission, (R. 505 and 507) is disproved by the record of achievment under the plan. The undisputed record of reductions in rates and the lessening in the cost of electric service, noted on page 7 and 8, *supra*, speak a denial of the assertions of this agency.

The charge made is contrary to the testimony of the only witness called by the Public Buildings Administration (R. 378, 379, 395, 396). It is also contrary to the testimony of Professor Bonbright (R. 408). It is contrary to the belief expressed by the consumers through the Federation of Citizens Associations (R. 10) and the People's Counsel.

In the Preface to his "Public Utility Regulations and the So-Called Sliding Scale", Mr. Bussing said that before the adoption of the sliding-scale arrangement, electric prices in the District of Columbia "were among the highest in the country; within eight years they were among the lowest." On page 126 he said that while the company's earnings have remained consistently above the basic rate, notwithstanding the fact the price to consumers has dropped from among the highest in the United States to one of the lowest. On pages 137 and 138 Mr. Bussing shows cumulative savings under the sliding-scale plan from 1925 to 1935, inclusive, of $37,020,372. Mr. Bussing stated that the actual savings to the consumers have been greater than these figures indicate, for the latter are based on the assumption that consumption in the ensuing year would be no greater than it was in the previous period.

On page 18 of the Petition, the Petitioner says the actual excess earnings to the company are many millions of dollars greater than the $16,000,000 stated by the Commission on Record page 8 because under the Commission's practice excess earnings "was immediately added to the rate base".

This statement is not true. From the time the plan was adopted, to the initial rate base each year "there has been added the actual cost of subsequent net additions" (R. 12,

18). Under the sliding-scale arrangement for the determination of gas rates where the identical method of determining the rate base is employed, the Court of Appeals in *Washington Gas Gas Light Co.* v. *Byrnes*, 78 U. S. App. D. C. 107, 109, 137 F. 2d 547; and this Court in *Vinson* v. *Washington Gas Light Co.*, 321 U. S. 489, 492, said that the sliding-scale plan requires the rate base to be adjusted annually by adding net property additions at cost.

Contrary to the contention of the Public Buildings Administration that the sliding-scale arrangement was a device to extract from consumers unjust rates (R. 505), its witness, Mr. Smith, said, "I envy the sliding-scale arrangement because it has benefits to the public as compared to the typical fair-value procedure." (R. 396). The witness narrated some of the benefits of the sliding-scale arrangement (R. 378, 379, 398).

Professor James C. Bonbright of New York City, Economist, Professor of Finance in the Business School of Columbia University and specialist in public utility matters, who was called as a witness by the Procurement Division of the Treasury (R. 406), recommended certain modifications of the sliding-scale arrangement and stated "that the sliding-scale plan deserves substantial credit, both for the promptness and for the amount of the reductions in residential rates" (R. 408).

III

No Good Reason Is Advanced for Issuing a Writ of Certiorari

The Petitioner seeks a review of the decision below on nothing more than its argument that rates charged for electric service since January 1, 1925, have been illegal. The lower court said it is only by saying retroactively that the rates extracted in former years were not just and reasonable, that it could conclude that the surplus or undistributed earnings was an unlawful accumulation (R.659). All of the evidence shows

that surplus is actually invested in property used in the public service.

The decision of the lower court is not in conflict with any decision of this Court. Indeed, it is in accord with this Court's decision in *Vinson* v. *Washington Gas Light Co., supra.* The decision is not in conflict with that of any other Circuit Court of Appeals.

This is not a case of reviewing the statute for the first time. This Court construed paragraph 16 of the statute here involved in *Vinson* v. *Washington Gas Light Co., supra,* against the same attack that is made against it in the instant Petition. This Court also construed a sliding-scale plan adopted under the same paragraph of the Act as the one here involved.

No sufficient reason is advanced for granting a Writ of Certiorari.

CONCLUSION

It is respectfully submitted that the Petition for Writ of Certiorari should be denied.

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